

Message Text

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SUBJECT: U.S. DOMESTIC ECONOMIC POLICY

1. THE PURPOSE OF THIS MESSAGE IS TO PROVIDE POSTS WITH SUMMARY INFORMATION ON THE STATE OF THE U.S. ECONOMY AND ON U.S. DOMESTIC ECONOMIC POLICY FOR USE IN DISCUSSIONS WITH THE HOST GOVERNMENTS, BUSINESSMEN AND JOURNALISTS.

2. SINCE THE SEVERE WORLD-WIDE RECESSION OF 1974-1975, THE U.S. ECONOMY HAS BEEN EXPANDING AT A PACE ABOVE ITS LONG-TERM POTENTIAL GROWTH. IN 1976 U.S. REAL GNP GREW AT A 6 PERCENT RATE; IN 1977 IT GREW AT 4.9 PERCENT.
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OUTLOOK FOR 1978 IS FOR A REAL GROWTH RATE OF 4 - 4 1/4 PERCENT. A VERY SLIGHT DECLINE IN REAL GNP IN THE FIRST QUARTER WILL PROBABLY BE FOLLOWED BY A STRONG SURGE IN THE SECOND QUARTER. RECOVERY IN MOST OTHER NATIONS HAS LAGGED FAR BEHIND OUR OWN. REAL GROWTH IN THE EC LAST YEAR WAS LESS THAN 2 PERCENT AND IN JAPAN SLIGHTLY ABOVE 5 PERCENT. INDEED, A MAJOR REASON FOR THE U.S. TRADE DEFICIT LAST YEAR WAS THE SLOW GROWTH IN THE ECONOMIES OF OUR MAJOR TRADING PARTNERS.

3. UNEMPLOYMENT IN THE U.S., WHICH IN 1975 WAS 8.5 PERCENT OF THE CIVILIAN LABOR FORCE, IS CURRENTLY ABOUT 6.0

PERCENT. DURING THE COURSE OF OUR RECOVERY, WE HAVE MADE MORE PROGRESS THAN ANY OTHER INDUSTRIAL COUNTRY IN REDUCING UNEMPLOYMENT AND IDLE CAPACITY. IN 1977 ALONE, MORE THAN 4 MILLION NEW JOBS WERE CREATED IN OUR COUNTRY -- AN ALL-TIME RECORD -- AND UNEMPLOYMENT WAS REDUCED BY MORE THAN 1 MILLION PERSONS. MOREOVER, THE AFTER-TAX INCOME OF CONSUMERS, ADJUSTED FOR INFLATION, ROSE SUBSTANTIALLY IN 1977. WAGES OF THE TYPICAL AMERICAN WORKER INCREASED BY MORE THAN THE RISE OF PRICES, AND BUSINESS PROFITS ALSO ADVANCED.

4. OUR INFLATION RATE IS ALSO LOWER THAN IN MOST NATIONS. THE GNP IMPLICIT PRICE DEFLATOR WAS 5.3 PERCENT IN 1976, 5.5 PERCENT IN 1977. THE CONSUMER PRICE INDEX ROSE BY 5.8 PERCENT IN 1976 AND 6.5 PERCENT IN 1977. HOWEVER, INFLATIONARY PRESSURES HAVE BEEN ACCELERATING AND THE FIRST QUARTER OF 1978 REGISTERED A 7.8 PERCENT INCREASE IN CONSUMER PRICES WITH FOOD PRICES INCREASING AT A 12.4 PERCENT ANNUAL RATE. SOME MODERATION LATER IN THE YEAR IS EXPECTED BUT THE UNDERLYING INFLATION RATE IS NOW CLOSER UNCLASSIFIED

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TO 7 THAN 6 PERCENT.

5. THE PRESIDENT IN HIS ANTI-INFLATION SPEECH ON APRIL 11 MADE CLEAR HIS DETERMINATION TO CONTROL AND REDUCE THE RATE OF INFLATION WHICH, ALTHOUGH BETTER THAN IN MOST COUNTRIES, IS STILL TOO HIGH TO BE ACCEPTABLE. HE INTENDS TO MAINTAIN TIGHT CONTROL OVER THE GROWTH OF FEDERAL SPENDING, TO SECURE PASSAGE OF LEGISLATION TO CONTROL RISING COSTS IN SPECIFIC PROBLEM SECTORS SUCH AS HEALTH CARE, AND TO ENCOURAGE VOLUNTARY DECELERATION OF THE WAGE-PRICE SPIRAL.

6. THE ADMINISTRATION PARED BACK AND DELAYED OUR PROPOSED TAX CUT; IT IS MAKING EVERY EFFORT TO REDUCE FUTURE BUDGET DEFICITS; IT HAS TAKEN STEPS TO REDUCE INFLATION CREATING REGULATIONS; IT HAS DIRECTED ALL FEDERAL AGENCIES TO OBSERVE THE PRINCIPLE OF DECELERATION IN ALL NEW OR RENEGOTIATED FEDERAL CONTRACTS. ON APRIL 11, PRESIDENT CARTER ANNOUNCED THAT HE WOULD ORDER A FREEZE ON THE SALARIES OF ALL EXECUTIVE EMPLOYEES AND SEEK TO LIMIT INCREASES IN FEDERAL WHITE-COLLAR SALARIES TO 5.5 PERCENT THIS YEAR. THE CONGRESS I, NOW CONSIDERING IMPOSING SIMILAR RESTRAINTS IN HIGH LEVEL PAY ON ITSELF AND ON THE JUDICIARY. THE ADMINISTRATION IS ASKING THE PRIVATE SECTOR -- LABOR AND BUSINESS -- TO ADHERE TO THE PRINCIPLE OF WAGE AND SALARY DECELERATION THAT WE ARE APPLYING TO FEDERAL EMPLOYEES. IN RECENT WEEKS, GENERAL MOTORS, FORD

AND AT&T HAVE ANNOUNCED THEIR INTENTION TO PUT TIGHT CONSTRAINTS ON EXECUTIVE SALARIES OVER WHICH THEY HAVE CONTROL. OTHER BUSINESS FIRMS HAVE FOLLOWED SUIT.

7. THE RECENT DECLINE IN THE VALUE OF THE DOLLAR, PRIMARILY AGAINST THE CURRENCIES OF COUNTRIES IN STRONG TRADE AND CURRENT ACCOUNT SURPLUS, IS ATTRIBUTABLE TO OUR LARGE TRADE DEFICIT IN 1977 AND THEIR LARGE SURPLUSES.
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THE BASIC CAUSES OF THAT DEFICIT WERE THE GROWTH OF U.S. PETROLEUM IMPORTS, WHICH ROSE BECAUSE OF AN INCREASE IN PRICE AS WELL AS QUANTITY, AND THE FACT THAT WE HAVE BEEN GROWING FASTER THAN OUR TRADING PARTNERS. OUR STRONG RECOVERY INCREASED DEMAND FOR IMPORTS WHILE THE SLOW GROWTH OF OUR TRADING PARTNERS SLOWED THE GROWTH OF OUR EXPORTS. FURTHERMORE, LAGGING BUSINESS INVESTMENT IN PLANT AND EQUIPMENT, WHICH HAS BEEN A MARKED FEATURE OF THE POOR GROWTH PERFORMANCE IN OECD COUNTRIES, RETARDED DEMAND FOR U.S. CAPITAL GOODS, WHICH CONSTITUTE ABOUT ONE-THIRD OF OUR TOTAL EXPORTS. AND WITH GOOD GRAIN HARVESTS AROUND THE WORLD, OUR FOOD AND FEED GRAIN EXPORTS DECLINED AS WELL.

8. IT SHOULD BE NOTED THAT THE RECENT DECLINE IN THE DOLLAR FOLLOWED A PERIOD OF ABOUT TWO AND ONE-HALF YEARS OF DOLLAR APPRECIATION. THE RESULT HAS BEEN THAT, AT THE PRESENT TIME (JUNE 2, 1978), THE DOLLAR HAS A HIGHER VALUE VIS-A-VIS THE CURRENCIES OF OTHER INDUSTRIALIZED COUNTRIES ON A TRADE-WEIGHTED BASIS THAN IT HAD IN MARCH OF 1973.

9. THE PRESIDENT IS DETERMINED TO REDUCE U.S. DEPENDENCE ON IMPORTED OIL. SHOULD THE CONGRESS FAIL TO ACT ON THE CRUDE OIL EQUALIZATION TAX PROPOSAL, THE ADMINISTRATION WILL CONSIDER ALTERNATIVE MEASURES TO ACHIEVE THE SAME RESULT.

10. THE BASIC PREMISE OF THE NATIONAL ENERGY PLAN IS THAT WE CAN AND MUST CUT THE RATE OF GROWTH IN OUR ENERGY DEMAND FROM AN AVERAGE OF 3.5 PERCENT FROM 1950 TO 1973 TO LESS THAN 2 PERCENT BY 1985, AND REDUCE OUR OIL IMPORTS TO ABOUT 6 MILLION BARRELS PER DAY. THIS
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IS TO BE DONE WITHOUT SACRIFICING A HEALTHY RATE OF ECONOMIC GROWTH. THE GOALS ARE TO BE ACHIEVED THROUGH USING ENERGY MORE EFFICIENTLY, AND USING DOMESTIC RESOURCES, PARTICULARLY COAL, TO MEET INCREMENTAL DEMAND.

AS IT IS NOW EMERGING FROM CONGRESS. THE PLAN WILL NOT BE STRONG ENOUGH TO ALLOW US TO FULLY ACHIEVE OUR OBJECTIVES. WE WILL, HOWEVER, CONTINUE

TO PROPOSE ADDITIONAL MEASURES UNTIL WE CONSIDER OUR OVERALL PROGRAM TO BE ADEQUATE FOR OUR NATIONAL SECURITY AND ECONOMIC WELFARE.

11. WE ARE ENCOURAGED AT THE PROGRESS MADE TOWARD A COMPROMISE ON NATURAL GAS PRICING. SECRETARY SCHLESINGER IN HIS MAY 26 PRESS CONFERENCE ESTIMATED THAT THE INCREASED PRODUCTION RESULTING FROM NEW PRICING POLICY COULD SAVE AS MUCH AS ONE MILLION BARRELS OF OIL IMPORTS PER DAY. THE FATE OF THE CRUDE OIL EQUALIZATION TAX, HOWEVER, REMAINS A MATTER OF CONSIDERABLE CONCERN. THIS IS IN MANY RESPECTS THE HEART OF THE PLAN. FAILURE TO PRICE OIL AT WORLD LEVELS EFFECTIVELY SUBSIDIZES THE USE OF IMPORTED OIL, BURDENS US WITH AN AWKWARD REGULATORY SYSTEM, AND INHIBITS INVESTMENTS DESIGNED TO MAKE MORE EFFICIENT USE OF ENERGY AND INCREASE PRODUCTION OF ALTERNATIVE ENERGY SOURCES.

12. THERE HAVE BEEN SOME ENCOURAGING TRENDS IN DOMESTIC ENERGY USE THAT HAVE COME TO LIGHT IN RECENT WEEKS. PRELIMINARY FIGURES INDICATE THAT ENERGY CONSUMPTION IN 1977 GREW ONLY ABOUT 2.2 PERCENT, SIGNIFICANTLY LESS THAN THE GROWTH IN GNP, WHICH WAS ABOUT 5 PERCENT. THE HISTORIC RATIO HAS BEEN ABOUT ONE TO ONE. ENERGY USE IN THE TRANSPORTATION AND RESIDENTIAL/COMMERCIAL SECTORS INCREASED AT A LOWER RATE THAN IN 1976, BUT THE MOST STRIKING SHIFT WAS IN THE INDUSTRIAL SECTOR WHERE THE INCREASE FOR 1977 WAS ONLY .11 PERCENT, CONSIDERABLY UNCLASSIFIED

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BELOW THE ALMOST 7 PERCENT INCREASE OF 1976. PART OF THIS DECLINE IS DUE TO THE FACT THAT THE RATE OF INCREASE IN INDUSTRIAL PRODUCTION FELL FROM A VERY HIGH 10.2 PERCENT IN 1976 TO ABOUT 5.6 PERCENT IN 1977. WE ARE NOW ANALYZING THE DATA TO DETERMINE HOW MUCH OF THE DECLINE TO ATTRIBUTE TO CYCLICAL FACTORS AND HOW MUCH TO STRUCTURAL FACTORS.

13. UNEMPLOYMENT RATES AMONG YOUTH AND MINORITY GROUPS ARE SUBSTANTIALLY HIGHER THAN NATIONAL AVERAGES. THE UNEMPLOYMENT RATE FOR BLACK TEENAGERS IS NEARLY 40 PERCENT. THE NECESSITY TO TAKE EFFECTIVE AND ADEQUATE MEASURES TO INCREASE THE EMPLOYMENT OPPORTUNITIES OF THE DISADVANTAGED IS AN IMPORTANT ELEMENT OF THE ADMINISTRATION'S 1979 BUDGET PROPOSALS.

14. IN 1977 THE CONGRESS APPROPRIATED \$8.4 BILLION TO EXPAND THE PUBLIC SERVICE EMPLOYMENT PROGRAM TO 725,000

JOBS AND TO TARGET THESE JOBS TO THE LONG-TERM UNEMPLOYED
AND THE ECONOMICALLY DISADVANTAGED. THE YOUTH EMPLOYMENT

AND DEMONSTRATION PROJECTS ACT OF 1977 WILL PROVIDE
166,000 FULL-TIME EQUIVALENT WORK AND TRAINING POSITIONS
FOR UNEMPLOYED YOUTH. THE PROPOSED BUDGET WOULD
CONTINUE THE PUBLIC SERVICE JOBS AND WOULD EXPAND OPPOR-
TUNITIES FOR EMPLOYMENT AND SKILL TRAINING FOR THE
UNEMPLOYED YOUTH WHO NEED THE MOST HELP. THE 1979 BUDGET
CONTAINS A \$400 MILLION INITIATIVE THAT WILL HELP CREATE
ON-THE-JOB TRAINING OPPORTUNITIES IN PRIVATE BUSINESS
FOR POVERTY YOUTHS. IN ADDITION, THE ADMINISTRATION HAS
JUST RECENTLY PROPOSED A TARGETED EMPLOYMENT TAX CREDIT
DESIGNED TO ENCOURAGE YOUTH EMPLOYMENT.

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15. THE PRESIDENT'S TAX PROPOSAL CONTAINS SEVERAL PRO-
VISIONS DESIGNED TO STIMULATE PRIVATE INVESTMENT. THE
INCOME TAX RATE FOR MOST SMALL CORPORATIONS WOULD BE
REDUCED BY ABOUT 10 PERCENT WHILE THE TAX RATE FOR LARGE
CORPORATIONS WILL BE REDUCED FROM 48 PERCENT TO 45 PER-
CENT EFFECTIVE JANUARY 1, 1979, AND TO 44 PERCENT BY
JANUARY 1, 1980. THE INVESTMENT TAX CREDIT WOULD BE
MADE PERMANENT AT 10 PERCENT AND EXTENDED TO INVESTMENTS
IN MANUFACTURING AND UTILITY STRUCTURES. THE CORPORATE
TAX REDUCTIONS AND THE EXTENSIONS OF THE INVESTMENT
TAX CREDIT ARE EXPECTED TO ENCOURAGE CAPITAL FORMATION
BY INCREASING CASH FLOW AND AFTER-TAX PROFITS. VIGOROUS
BUSINESS INVESTMENT WILL EASE INFLATIONARY PRESSURE BY
AVERTING CAPACITY SHORTAGES AND BY CONTRIBUTING TO
IMPROVED PRODUCTIVITY PERFORMANCE.

16. TO SUMMARIZE, THE U.S. ECONOMY IS STRONG. THE
PRESIDENT IS DETERMINED TO CONTINUE TO MOVE STEADILY
TOWARD A HIGH EMPLOYMENT ECONOMY WHILE CONTAINING AND
REDUCING THE RATE OF INFLATION AND DECREASING OUR EXCES-
SIVE DEPENDENCE ON IMPORTED OIL. WHILE DRAMATIC IMPROVE-
MENT IN THE U.S. TRADE BALANCE THIS YEAR IS NOT
EXPECTED, SOME IMPROVEMENT SHOULD OCCUR FROM THE GREATER
CONVERGENCE OF GROWTH RATES IN THE OECD COUNTRIES, THE
FREEZE ON OPEC OIL PRICES, AND THE POSITIVE EFFECT ON OUR
TRADE BALANCE OF THE DOLLAR DEPRECIATION ALREADY
EXPERIENCED.

17. ANY REACTIONS FROM POSTS ON USEFULNESS OF THIS
REPORT AND SUGGESTIONS WOULD BE APPRECIATED. VANCE

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